

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of)
)
AMERICAN SAVINGS AND LOAN ASSOCIATION)

Appearances:

For Appellant: Neil R. Bersch
 Certified Public Accountant

For Respondent: Gary Paul Kane
 Counsel

O P I N I O N

These appeals are made pursuant to section 26077 of the Revenue and Taxation Code from the disallowance by the Franchise Tax Board of the claim of American Savings and Loan Association for refund of franchise tax in the amount of \$51,568.78 for the income year 1959, and pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of American Savings and Loan Association against proposed assessments of additional franchise tax in the amounts of \$35,863.68, \$119,145.91 and \$175,096.07 for the income years 1960, 1961 and 1962, respectively. The refund claim was deemed disallowed pursuant to section 26076 of the Revenue and Taxation Code since the Franchise Tax Board failed to act on it within six months after it was filed.

Appellant American Savings and Loan Association is a California corporation which was created in 1920 as Whittier Savings and Loan Association. In 1956 Whittier purchased substantially all of the assets of two other associations: Intervalley Savings and Loan Association, created in 1930 or 1931, and possessing one office at the time of the sale; and American Savings and Loan Association (Old American), formed in approximately 1928,

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December 31, 1958, a moving average is to be employed on a basis of 20 years experience, including the income year. This period of time was selected since it 'represents a sufficiently long period of an association's experience to constitute a reasonable cycle of good and bad years. However, in lieu of the moving average experience factor an association may use an average experience factor based on any 20 consecutive years after the year 1927; provided, that for any 20-year period selected the association must use its own bad debt loss experience for the years that it was in existence during, the period selected and the average bad debt loss experience of similar associations located in this State for such years as are necessary to complete the 20-year period. Associations which have not been in existence 20 years, see subparagraph (3)(ii)....

(i) In computing the moving average or alternative method percentage of actual bad debt losses to loans, the average should be computed on loans comparable in their nature and risk involved to those outstanding at the close of the current income year involved.. ..

(ii) A newly organized association or an association which arises as the result of a merger, consolidation or the acquisition of substantially all of the assets of a predecessor association without sufficient years' experience for computing an average as provided for above will be permitted to set up a reserve commensurate with the average experience of other similar associations with respect to the same type of loans. If such association has not been in existence during all or part of either of the 20-year periods described at the beginning of this paragraph, it must use an average bad debt loss experience factor consisting of its own bad debt losses during the years for the period selected plus the average bad debt losses of similar associations located in this State for such years as are necessary to complete either of the 20-year periods selected.... The average bad debt loss for each year from 1928 to, 1947, inclusive, is as follows:... In determining the average experience of similar associations the experience of associations which have

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conclusion was that a meaningful loss experience, in the case of an association which is an amalgamation of previously existing associations, may be achieved by combining the loss experience of all, and therefore the Franchise Tax Board's determination was upheld. We followed the above decision in the Appeal of The United Savings and Loan Association, Cal. St. Bd. of Equal., decided November 19, 1968.

Appellant contends that since the instant case involves a taxable purchase of assets it is distinguishable from Anneals of Home Savings and Loan Association, et al., supra, and the federal cases which it relied on, because they were concerned with transactions which were in effect reorganizations in the form of mergers. In amplification of this argument appellant states that loan policy, as determined by ownership and management, is a key factor influencing the nature and risk of loans made and consequently the amount of losses which an association will suffer. Appellant states that ownership and management are much more likely to be continuous in a transaction involving a reorganization than in one concerned with a purchase of assets. Appellant argues that in the instant situation after the purchases the only continuous ownership and management influencing future losses was appellant's, and therefore only its bad debt loss experience should be used to estimate these losses.

We do not think that this distinction between a reorganization and a purchase of assets is significant in the instant type of situation. The Revenue and Taxation Code contains several definitions of the term "reorganization" for the limited purposes of providing for the transfer of tax liability, or for a change of corporate structure without recognition of gain or loss. However the instant case presents the very different problem of the information to be used for the estimation of future bad debt losses which will be suffered by a savings and loan association. Regulation 24348(a), subdivision 3(ii), supra, recognizes this difference and uses language which not only includes certain types of reorganizations -- mergers and consolidations -- but also the acquisition, or transfer, "of substantially all of the assets of a predecessor...." Also, it is well established that a taxing authority does not abuse its discretion by requiring that a taxpayer use its own bad debt loss experience, instead of substituted experience, despite a showing by the association that its ownership or management has been changed. (First National Bank of

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of Whittier's loss experience. Regulation 24348(a) provides in part:

(6) Bonds. Bonds which become worthless, although falling in the category of bad debts, shall be excluded in computing a reasonable addition to reserve. The amount determined as worthless in whole or in part in respect to bonds shall be allowed as a deduction in addition to the amount allowed as an addition to the reserve for bad debts.

(7) Effective Date and Applicability. This regulation: is applicable for all income years beginning after December 31, 1958....

Appellant contends that the regulation does not apply because the losses occurred prior to the effective date of the regulation. However this date is stated in terms of the income years at issue, and in the present case all of those years began after December 31, 1958. Appellant also states that the losses in question were partial losses due to a decline in market value, and argues that as such they were not losses on worthless bonds. We do not agree. The language of subdivision (6), read as a whole, explicitly covers the instant situation. We conclude that these bond losses should have been excluded from the computation of Whittier's loss experience.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,